United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

74-1023

United States Court of Appeals
FOR THE SECOND CIRCUIT

1050 TENANTS CORP., HERBERT SALTZMAN and JOAN SALTZMAN,

Plaintiffs-Appellees,

against

PETER JAKOBSON, JOHN R. JAKOBSON, ARTHUR D. EMIL and LAWRENCE A. KOBRIN,

Defendants-Appellants.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF FOR DEFENDANTS-APPELLANTS

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REPLY BRIEF FOR DEFENDANTS-APPELLANTS

This reply brief is submitted on behalf of defendants-appellants to rebut certain of plaintiffs-appellees' arguments or statements which are not already covered in the appellants' brief heretofore submitted.

POINT I

The shares of plaintiff 1050 Tenants Corporation are not "stock" within the meaning of the federal securities laws.

In their brief, plaintiffs-appellees continue to ignore the fact that the transaction at bar constituted primarily the purchase of a home—a cooperative apartment. A review of the offering plan (33a-97a) clearly demonstrates this fact. Plaintiffs point to a few isolated paragraphs of the offering plan which incidentally refer to the shares; they ignore the overwhelming preponderance of the offering plan which was devoted to the apartment—the real estate.

In doing so, they persist in the attempt to disguise the essence of the transaction. The purchasers of the apartments at 1050 Park Avenue are home owners, not investors in securities.

Appellees' reliance on *Stockton* v. *Lucas*, 482 F.2d 979 (Temp. Emerg. U.S. Ct. App. 1973) is misplaced; that case is not relevant to the issue presented in this case. In *Stockton*, the question of whether a share in a cooperative housing corporation was a security *within the meaning of the federal securities laws* was not presented. The question presented in *Stockton* was whether the Economic Stabilization Act of 1970[1] or the Phase I Executive Order and regulations issued thereunder, should control the sale of shares in a cooperative housing corporation. In reaching the determination that such shares were not subject to such regulations, the Court did not consider the issue of whether these shares were "stock" within the meaning of the federal securities laws.

As shown in appellants' main brief, Congress never intended and has not placed the sale of cooperative housing apartments within the ambit of the federal securities laws. This policy determination has been supported and adhered to by the federal courts and the Securities and Exchange Commission.[2] The question of how cooperative apartments are treated under wage and price controls is simply not relevant to the issue presented here.

Particularly disturbing is plaintiffs-appellees' attempt to point to an out of context quotation from Prof. Loss at page 14 of their brief to support a proposition on which Prof. Loss takes a diametrically opposite point of view. A review of the full text of Prof. Loss' view at pp. 491-92 of his treatise will clearly show his position as to this question.

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[1] 12 U.S.C. § 1904.

[2] See defendants-appellants' main brief, pp. 14-21.

Plaintiffs urge this Court to sustain the District Court because "the federal securities laws should be liberally and broadly construed and applied."[3] We agree that Congress, in enacting legislation to protect *investors,* wanted the Courts to apply liberally these remedial legislations. But Congress never intended that these statutes apply to the sale of homes; they are real estate and not securities. Time and time again the Congress considered and specifically rejected the approach urged by plaintiffs-appellees.[4]

Plaintiffs-appellees similarly continue to ignore this Court's implied reversal of the District Court's opinion in *Movielab, Inc.* v. *Berkey Photo, Inc.,* 452 F. 2d 662 (2d Cir. 1971). While this Court did sustain the decision of the District Court in *Movielab,* it specifically rejected the reasoning and language urged upon this Court by appellees. In *Movielab,* this Court said that the phrase "any note" "includes some notes at the very least." 452 F. 2d at 663. This language cannot support the conclusion that it means "all notes" and, presumably, "all stock."

POINT II

Applicable law supports the view that the sale of cooperative apartments does not involve the sale of securities within the meaning of the federal securities law.

The applicable state law in many jurisdictions clearly demonstrates that the transaction in the instance case does not involve a "security" within the meaning of the federal securities laws. Plaintiffs-appellees have not pointed to a

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[3] Plaintiffs-appellees' main brief, p. 9.

[4] See legislative history of the Interstate Land Sales Full Disclosure Act (15 U.S.C. §§ 1701-1720) set forth at pp. 15-17 of defendants-appellants' main brief.

single case reaching the opposite result. Instead, at page 19 *et seq.* of their brief, plaintiffs-appellees review the present state of authority in several jurisdictions in a misleading fashion. Thus, they assert that *Brothers* v. *McMahon,* 251 Ill. App. 321, 115 N.E. 2d 116 (1953) has been legislatively reversed. This is simply not true. In making their assertion, appellees rely upon a single law review article. Professor Miller, however, disagrees:

> "A reading of the new Act does not seem to support his argument; few changes were made and none specifically in point."
>
> ". . . *Brothers* v. *McMahon* has not been reversed; *State* v. *Silberberg* is good law in Ohio; Florida, passing over an impassioned law review appeal, has declared shares in cooperative apartment corporations to be outside the Florida Securities Act; I have not discovered a federal case." Miller, *Cooperative Apartments: Real Estate or Security?,* 45 Boston U.L. Rev. 465, 485 (1965).

Appellees similarly attempt to distinguish *State* v. *Silberberg,* 166 Ohio St. 101, 139 N.E. 2d 419 (Ct. App. 1956). They conveniently ignore extensive analysis of the *difference* between real estate and securities in *Silberberg.*[5]

Likewise, the authorities relied upon by appellees at page 21 of their brief in an attempt to refute the authority of *Willmont* v. *Tellone,* 117 So. 2d 610 (Fla. Dist. Ct. App. 1962) do not merit great weight. The same authorities were specifically considered by the Florida court and conclusively rejected. Thus, appellees now attempt to have this Court approve these authorities as stating the applicable law of Florida after the Florida courts considered these opinionated articles and rejected their views.

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[5] 139 N.E. 2d at 344-346.

Likewise, plaintiffs rely upon *Silver Hills Country Club* v. *Sobieski,* 55 Cal. 2d 811, 361 P. 2d 906, 13 Cal. Rptr. 186 (1961). It must be remembered that this is a case in which plaintiffs-appellees cannot point to a single Federal Court following (although many have considered) and should not be given any weight by this Court.

As we correctly demonstrated in our main brief (page 21) state decisions have treated real estate sale transactions as mutually exclusive with a regulated security sale. Thus, by reliance on a highly opinionated student note published in a law review, plaintiffs-appellees have misstated the state of the law as to the questions presented in the case in the jurisdictions which the parties analyzed.

Likewise, plaintiffs-appellees' rejection of *Forman* v. *Community Services Inc.,* 366 F. Supp. 1117 (S.D.N.Y. 1973) as inapplicable is ignoring the clear import of that decision. As we demonstrated in our main brief, even if the shares in *Forman* were "securities," the opposite result should be reached here. *A fortiori,* if it is finally determined that the *Forman* shares are not securities, then the factual distinctions between the cases virtually compel that the same result be reached here. See defendants-appellants' discussion in the main brief, pp. 32-35.

POINT III

Strong public policy reasons support the traditional view that real estate transactions are governed by local law.

It has always been accepted that local law should control questions concerning the transfer of realty. Congress has consistently supported the wisdom of this policy, as have the courts. There are sound public policy reasons for this centuries-old tradition and rule of law. Plaintiffs-appellees offer no reason, convincing or otherwise, why this

policy should here be reversed. Rather, they merely state the alleged need for the federal government to become involved in local matters.

Such a position is hardly tenable in face of the highly sophisticated and complex series of New York statutes designed and enforced with the specific purpose of protecting the interest sought to be protected by plaintiffs here. The federal government and its Courts are ill-equipped to resolve the myriad of local problems and need for regulation in a highly individual manner required and provided by comprehensive state regulation. Public policy requires that regulation and control in this area remain with the states. See *Ryan* v. *J. Walter Thompson Co.*, 453 F. 2d 444 (2d Cir. 1971).

POINT IV

The District Court lacks jurisdiction over this matter because the complaint fails to allege cognizable damages.

This action should be dismissed by this Court because the plaintiffs-appellees fail to allege in their complaint that they have suffered damages which are cognizable under the federal securities laws. In fact, plaintiffs have suffered no such damages.

To recover damages under the federal securities laws, a plaintiff must plead that the securities purchased are worth less than the amount actually paid for them. While in a state court action for damages for breach of contract, plaintiffs might bring an action to recover the *expected* benefits of the bargain, in an action under the federal securities laws this is not permitted. *Wolf* v. *Frank*, 477 F.2d 467 (5th Cir. 1973) *cert. den.*, 42 L.W. 323 (10/23/73); *Securities and Exchange Commission* v. *Manor Nursing Centers, Inc.*, 458 F. 2d 1082 (2nd Cir. 1972).

The failure to plead cognizable damage is so basic a defect as to deprive the court of subject matter jurisdiction. In *Fershtman* v. *Schectman,* 450 F.2d 1357 (2d Cir. 1971), *cert. den.* 405 U.S. 1066 (1972), this Court (Friendly, C.J.) affirmed the dismissal of a complaint because, *inter alia,* it was clear that plaintiff had suffered no justiciable loss:

> "But we have held very recently that even a buyer defrauded in violation of the securities laws 'is entitled to recover only the excess of what he paid over the value of what he got * * * the difference between the value of what he got and what it was represented he would be getting.'" 450 F.2d at 1361.
>
> * * *
>
> "The district court dismissed the complaint for failure to state a claim on which relief could be granted. We think the dismissal should have been for want of federal jurisdiction. With that modification, the order is affirmed." *Id.*

In *Levine* v. *Seilon,* 439 F.2d 328 (2d Cir. 1971), the vitality of the rule laid down in *Janigan* v. *Taylor,* 344 F.2d 781 (1st Cir. 1965), *cert. denied* 382 U.S. 879 (1965), with respect to the measure of damages applicable to a federal securities action by a defrauded buyer was restated by this Court with approval:

> "Under the 'general' laws regime of *Swift* v. *Tyson,* 41 U.S. (16 Pet.) 1, 10 L. Ed. 865 (1842), the rule in the federal courts was that a defrauded buyer of securities is entitled to recover only the excess of what he paid over the value of what he got, not, as some other courts had held, the difference between the value of what he got and what it was represented he would be getting . . . This also is the governing rule under Rule 10b-5 in cases of defrauded buyers . . ." 439 F.2d at 334 (most citations omitted.)

Plaintiffs do not allege in their complaint any allegation that the apartments which were purchased were worth less than was paid for them. In fact, plaintiffs allege the very damages *not* cognizable under the federal securities laws. Paragraph 10(d) of the complaint (7a-8a) alleges:

> "10. Common questions of law and fact exist as to all members of the Class, including inter alia:
>
> * * *
>
> (d) to what extent the shares of stock of the Corporation sold to the members of the Class were worth less than they would have been had the representatives and statements made by defendants to the members of the Class been true and complete."

Therefore, under the rule of law in this circuit this Court should now find a lack of subject matter jurisdiction due to failure to allege cognizable damages and dismiss the complaint.

CONCLUSION

The order of the Court below should be reversed and this Court should enter an order requiring the District Court to dismiss this action for want of subject matter jurisdiction relegating plaintiff's claims to the State Courts of New York, the proper forum in which plaintiffs can and will receive a full hearing on all the issues raised in this matter.

Respectfully submitted,

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